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CITY OF MEDICINE

**CITY OF DURHAM |** NORTH CAROLINA

**Date:** **April 16, 2010**

**To:** **Thomas J. Bonfield, City Manager**
**Through:** **Keith Chadwell, Deputy City Manager**
**From:** **Mike Barros, Director**
**Department of Community Development**
**Subject:** **Local Funding Commitment for Rolling Hills Submission to NCHFA**

## Executive Summary

The application for the first phase of mixed-income rental development in the Rolling Hills/Southside project area is due to the North Carolina Housing Finance Agency (NCHFA) on May 14, 2010. The application submittal must include a commitment from the City of Durham to provide subordinate financing for the project and a commitment from the City to fund the site preparation and infrastructure improvements to serve the rental development. This initial phase will consist of 119 mix-income rental units and 13 live-work units.

## Recommendation

The Department of Community Development recommends that City Council authorize the City Manager to issue to MBA Development Corporation a conditional commitment of subordinate financing in the amount of $5,486,468.00 for a rental development consisting of 119 mix-income units and 13 live-work units and a conditional commitment to fund the associated site preparation and infrastructure improvements at an amount not to exceed $3,887,410.00.

**Background**
While the scope of the predevelopment agreement between the City and McCormack Baron Salazar calls for a comprehensive redevelopment plan for the entire Rolling Hills/Southside project area, a particular focus over the past six to nine months has been an initial "tipping point" project of approximately 250 mixed-income rental units and 40 homeownership units to be developed over the next three to four years. Accordingly, the master planning efforts have focused on the Rolling Hills site and property in the Southside neighborhood owned by the Center for Community Self Help to establish a two-phased approach for completing those units. In brief, those phases are as follows:

Phase1 Rental: 119 rental units and 13 live-work units along the Lakewood Avenue frontage of the Rolling Hills site.

Phase 2 Homeownership: 30 new single family units to be constructed on Hillside Avenue and Chestnut Street.

Phase 2 Rental: 116 mixed-income rental units on a portion of the Rolling Hills site facing Roxboro Street and on Self-Help controlled property along Piedmont Avenue and the existing Beamon Place.

Phase 2 Homeownership: 15 new single family units to be constructed on or near South Street.

The improvements or investments associated with completing the first two phases are outlined below:

Site Preparation: To accommodate the 340+ units planned for Rolling Hills and to develop the site in a way that reconnects it to the surrounding neighborhood, it will be necessary to rough grade the entire site before any public infrastructure can be constructed. Based on the grading plan that has been prepared, excess material must be exported from the site. Fortunately, the Beamon Place site requires fill and therefore, much of the excess soil from Rolling Hills will be used for that purpose. The estimated cost of the grading/site preparation is $2,514,510.00. This figure includes a 10% contingency and a 16% project management allowance.

Infrastructure: To serve the first phase of rental development, the storm water management improvements for the entire site must be completed. A new street and associated utilities will be constructed on the Rolling Hills site as an extension of Chestnut, connecting with a new north-south street segment connecting with Lakewood Avenue. The estimated cost for these improvements is

$1,372,900.00. Phase 2 infrastructure will complete all of the improvements on Rolling Hills necessary for full-build out of the site and will also include a new street and associated utilities through the existing Beamon Place connecting Roxboro Street with Piedmont Avenue. The estimated cost of the Phase 2 improvements is $2,481,386.00. Both infrastructure estimates include a 10% contingency and a 16% project management allowance.

To ensure the lowest possible construction costs, it is anticipated that both phases of infrastructure work will be bid as one package with phase 2 broken out as a bid alternate.

Beamon Place Acquisition: A portion of the second phase of rental development will be constructed on Self-Help owned property along Piedmont Avenue and the existing Beamon Place. Tentatively, Self-Help has determined a net cost of $805,000.00 for those properties to be acquired and conveyed to MBA Development Corporation. This net figure takes into account the City's $500,000.00 financial participation in the acquisition of some of the properties to be conveyed.

Rental Subordinate Financing: The 119 residential units plus the 13 live-work units to be developed in Phase 1 will further the objective of creating mixed-income communities. Thirty-three percent of the 119 units (39) will be market rate (as will the 13 live-work units), forty percent of the units (48) will be affordable to households with incomes at 60% of the area median income, ten percent of the units (12) will be affordable to households with incomes at or below 50% of the area median and seventeen percent of the units (20) will be affordable to households with incomes at or below 30% of the area median with 8 of these units reserved for formerly homeless households with special needs.

The recommended subordinate financing for Phase 1 will leverage just over $3.67 in other investment for each local dollar. As noted in the attached sources and uses summary, the total project cost is estimated to be $20,174,882.00. Sources of financing include a conventional first mortgage loan, a subordinate loan from the NCHFA Rental Production Program, North Carolina State Tax Credits, low income housing tax credit equity and subordinate financing from the City in the amount of $5,486,468.00.

Phase 2 will have a similar financial structure and a leverage factor of just under $4.12. This phase will also be one-third market rate, one third affordable at 60% of the area median and one third affordable at 40% of area median. It will also provide 8 units for formerly homeless individuals with special needs at or below 30% of the area median income.  The estimated amount of the City's subordinate financing for Phase 2 is $4,589,323.00.

While the final structure will be determined as a part of the Master Development Agreement, it is anticipated that the City's subordinate financing for both phases will be in the form of a 0% loan with a term of not less than 30 years.  Payments on the City's loan and NCHFA's Rental Production Loan will not be subject to a fixed amortization but will instead be made from project cash flows in excess of the required debt coverage ratio.  Cash flow payments on both loans will be made on a pro rata basis.  As noted in the sources and uses summary, the amount of the NCHFA loan is $1.2 million.  Based on the preliminary proforma that have been developed, the City would initially receive annual payments of about $25,000.00 for Phase 1 and about $29,000.00 for Phase 2.

<u>Homeownership Subordinate Financing</u>:  Based on the analysis performed by Self Help, the average per unit development cost (including acquisition and demolition) for homeownership units in the Southside area is projected to be just over $174,000.00.  However, based on its experience in Southwest Central Durham, Self Help projects that initial appraised values will average only approximately $110,000.00.  Therefore, construction cost write-downs averaging $64,000.00 per unit will be required until market conditions in the Southside neighborhood improve over time and the gap between cost and appraised value narrows.

Summary of Phase 1 Funding Commitment

| **Component** | **Estimated Cost** |
|---|---:|
| Subordinate Financing for Phase 1 Mixed-Income Rental Development | $5,486,468.00 |
| Rolling Hills/Beamon Place Rough Grading/Site Preparation | $2,514,510.00 |
| Infrastructure to Serve Phase 1 | $1,372,900.00 |
| **Total** | **$9,373,878.00** |

**Issues/Analysis**

The Rolling Hills/Southside redevelopment project is an ambitious undertaking and in many respects, could parallel such projects as the Durham Bulls Athletic Park in terms of its impact on the City.  To make the project possible, an equally ambitious financial commitment will be required.

Although it has affordable housing elements, the Rolling

Hills/Southside project is first and foremost a neighborhood revitalization strategy with the objective of attracting private, profit-motivated investment over the long term. Within the 120 acre project area, there are more vacant and deteriorated properties than available local and federal funding could feasibly address. The centerpiece of that strategy is a phased “tipping point” project characterized by superior design elements and a mixture of rental and homeownership opportunities for a broad range of incomes. In effect, the goal is to create market demand in a portion of the City where none currently exists. Beyond the approximately 290 units that will be created by these two initial phases, the potential exists for an additional 1,000 units over the next six to eight years given the catalytic effect it could have on the timing of the Heritage Square project, the redevelopment of Fayette Place and other private investments. As noted by the property tax revenue analysis which is attached, the first two phases alone are projected to generate $192,268.00 annually in City and County taxes which is $128,091.00 more than the tax revenues currently generated. It should be noted however that all Rolling Hills property acquired by the City will become tax-exempt in 2011.

At the present time, the City does not have the capacity to support any additional general fund supported debt and therefore, the only known funding sources are the HUD entitlement programs and a limited amount of derivative funding from the 1996 Housing Bond as outlined below. Nonetheless, every opportunity to obtain additional competitive or discretionary federal funding will be explored.

<u>CDBG Section 108</u>: CDBG regulations allow entitlement communities to borrow against future entitlement amounts for very large projects such as Rolling Hills/Southside. Loan collateral is required and for this project, a portion of the collateral could be those portions of the Rolling Hills site beyond Phases 1 and 2. The proposed financing scenario includes a Section 108 Loan of approximately $7,173,797.00 with a term of 20 years. Annual debt service would be approximately $553,968.00 from each entitlement year. The funds would be used for rough grading, site preparation, infrastructure improvements and the acquisition of Beamon Place.

<u>Housing Bond Derivative Funding</u>: Based on a preliminary analysis, the future revenue stream from existing bond-funded loans could support approximately $2,500,000.00 in new debt. An alternative that will also be explored is the sale of some portion of the existing bond loan portfolio. The bond-derived funds would be used to provide a portion of the subordinate financing for the first phase of mixed income rental development.

HOME Funds: Under the HOME program, entitlement communities are allowed to obtain bridge loans from internal or external sources for large development projects and then use some portion of the annual HOME entitlement for debt service. Funding obtained using this mechanism would provide the balance of the subordinate financing needed for Phase 1 rental ($2,986,000.00) and the subordinate financing needed for Phase 2 ($4,589,323.00). The loan would be amortized over a period of approximately 10 years.

The HOME funds needed to provide construction costs write-downs for homeownership development (approximately $2,527,285.00) would be drawn from the annual entitlement over a period of roughly five years. In addition to Self Help, subrecipient funding to help construct the homes could be allocated through a competitive process to other non-profit or for-profit developers. All new construction will be subject to design, energy-efficiency and green building standards.

Focusing a substantial portion of the entitlement resources on one geographic area to undertake a very large project does represent a significant shift from the past practice of multiple subrecipients and many smaller projects. Nonetheless, as indicated by the summary charts presented below, the funding scenario still allows for more than $2 million in funding which could potentially be used to support the development of housing for persons with special needs over the ten year period during which a dedication of HOME funds to the Rolling Hills/Southside project will be required.

CDBG Funding (Approximately $2.2 million Annually)

| Activity | Percentage of Funds |
|---|---|
| Community Development Administered Homeownership, Rehab & Repair Programs | 29% |
| Section 108 Debt Service for Site Prep & Infrastructure Serving 248 Residential Units in Phases 1 & 2 and up to 117 Future Units. | 26% |
| Miscellaneous Activities in Southside including Gateway/Streetscape Improvements, Street Construction and Acquisition | 3% |
| Funding of Neighborhood Improvement Services Code Enforcement Efforts in Low to Moderate Income Neighborhoods | 22% |
| Administration – Partial Funding for Personnel and Other Costs for the Department of Community Development | 20% |

HOME Funding (Approximately $1.5 million Annually)

| Activity | Percentage of Funds |
|---|---|
| CHDO Set-aside/Special Needs Housing | 15% |
| Subrecipient Funding for Homeownership Development in Southside | 34% |
| Bridge Loan Payments for the Development of 248 Mixed Income Rental Units | 41% |
| Administration – Partial Funding for Personnel Costs for the Department of Community Development | 10% |

To reflect the focus on Rolling Hills/Southside, staff within the Department of Community Development will re realigned to take on new roles and responsibilities in addition to ongoing monitoring and compliance duties. One of the most important of those new roles will be increased technical assistance to non-profit organizations which have frequently received federal funding in the past. Activities to be undertaken, some of which are already underway, include:

- Maintaining a data bank of foundation funding and providing grant writing assistance.
- Monitoring human service and related funding opportunities from federal agencies other than HUD and providing application preparation assistance.
- Establishing working relationships with the Offices of Community Affairs (or their equivalents) at North Carolina Central University, Duke, UNC-Chapel Hill and North Carolina State University. Youth mentoring and enrichment opportunities will be a particular focus of this effort.
- Functioning as a clearinghouse to match organization funding and support needs with corporate entities.
- Promoting enhanced collaboration among non-profit organizations with similar missions.
- Providing support in the preparation of business plans.

Community Development staff will also work closely with McCormack Baron Salazar's non-profit affiliate, Urban Strategies, to carry out Human Capital activities in the Southside area and to identify the resources and possible funding sources for those efforts.

**Alternatives**

The local commitment of funding is necessary not only to make the project financially feasible, but also for the application to NCHFA to earn points for that commitment. Without the commitment, an application cannot be submitted.

Funding announcements by NCHFA are expected in August and the commitment of funds is conditioned on the award of low income housing tax credits and other funding from that agency. Although the proposed project is believed to be very competitive, not all such projects are awarded funding on the first submittal. If funds are not awarded in FY 10, the Department would recommend that an application be submitted in FY 11 while other ongoing revitalization activities are started in the neighborhood.

Alternatively, Council could elect not to authorize the conditional commitment or to postpone the project for some period of time. Proceeding with the project now would take advantage of very competitive pricing in the construction industry and would spur job creation as well as continuing the momentum that has been established. Ensuring local hiring is an important stated goal.

Should Council decide not to proceed with the project, an alternative would be to complete the acquisition, relocation and demolition on the Rolling Hills site and then land bank it until the economy improves. At that time, the property could be sold through a Request for Proposal or bid process.

**Financial Impacts**

As outlined, the financing scenario has no impact on the general fund. Unless other funding sources are identified, the CDBG entitlement program will be impacted for a period of 20 years and the HOME entitlement program will be impacted for a period of approximately 10 years. A summary chart illustrating the approximate distribution of entitlement funds over a 20 year period is attached. As noted previously, collateral for the Section 108 loan is required.

**SDBE Summary**

If the commitment is authorized and the project is awarded low income housing tax credits and other funding by NCHFA, a detailed construction scope for all elements will be submitted to the Office of Equal Opportunity and Equity Assurance so that participation goals may be established.

Attachments

- Source and Use Summary
- Property Tax Revenue Analysis
- Rent Schedule
- Phasing Plan
- Income Chart
- Approximate Entitlement Distribution